1812

THE NATIONAL CITY BANK OF NEW YORK

1935

Economic Conditions
Governmental Finance
United States Securities

New York, February, 1935

General Business Conditions

THE favorable reports from the industries during the past month seem to dispel any remaining uncertainty as to the business prospect through the first quarter of the year, giving the optimists, for that period at least, plainly the better of the argument. On the basis of orders in hand, factory schedules, and trade prospects generally, the likelihood that industrial operations will average higher than in any first quarter since 1931 appears to be clearly established. The upward trend which began during the Fall has gained momentum since the turn of the year, chiefly from the rapid increase in automobile assemblies. Apparently the automobile manufacturers intend if possible to make a million vehicles during the quarter, which would be an increase of one-third over a year ago; and their demands for materials are requiring increased operations in other industries.

Not since 1930 have a million automobiles been turned out in the first quarter. It is suggested by some that this early expansion is in part a precaution against the contingency of labor troubles later in the season. However that may be, automobile sales have continued good, showing less than the usual Winter decline, and have been well above a year ago. The industry expects to sell perhaps 3,250,000 cars this year, against 2,780,000 in 1934, and is prepared to stock its dealers accordingly.

The rise in steel ingot production has been uninterrupted in 15 weeks, reaching 52.5 per cent of capacity in the last week of January, and is due principally but by no means entirely to automobile orders. Tinplate mills have speeded up, and farm equipment manufacturers and other miscellaneous buyers of steel have been placing more orders. It is particularly heartening to find the farm equipment companies mentioned once more as factors in the steel markets, even though their part is moderate. Not only will the general business situation be greatly benefited by improvement in the business of these companies, which in both 1928 and 1929 had over half a billion dollars of sales, but if the farmers are in a position to buy more equipment they can buy more of other things also.

Textile mills in the main have a good volume of unfilled orders, and will give steady support to business during the quarter. The woolen mills have been unable to keep up with the demands of the clothing manufacturers for deliveries, and many of the men's wear mills particularly are booked to capacity to April 1. The recovery of this industry since its September low point has been sensational, the monthly consumption of raw wool having tripled. Silk mills are busier than a year ago, and rayon mills also, with unfilled orders representing a month's production. Cotton mill operations recovered promptly from the holiday curtailment, and are nearly as high as at the peak last year, while in the judgment of the market a good part of the Spring cotton goods business is still to be placed.

The industries cited are all very important in the business life of the country, and although there are other important ones, such as construction, which are holding back progress, the composite indexes which supply the best measures of general industrial activity have of course advanced sharply. The Federal Reserve Board's index of industrial production for the month of December, after adjustment for seasonal trends, shows a sensational rise to 85 per cent of the 1923-25 average compared with 74 in November. A further advance during January is indicated. In December, 1933, this index was 75 and since then it has been as high as 86 in May last year and as low as 71 in September. The current upswing thus has been more rapid and vigorous than that of last Spring and the volume of production is already at the peak reached last Spring, with due allowance for the difference in seasons.

Three Factors Favorable for Spring Trade

This upturn in industry, with the resulting expansion in employment and manufacturing

payrolls, is the first of three factors which may be noted as favorable for Spring trade. The second is the likelihood that the farmer will give perhaps more support to business than he did a year ago, when farm buying was a great factor in the Spring rise. Both the A.A.A. and the Department of Agriculture estimate that farm income during the first half of 1935 will be larger than in 1934. The volume of products marketed will be smaller, but the higher prices will offset the shrinkage in quantity. It is to be expected that the effects of the drouth and the elimination of the surplus in many of the farm markets will continue evident, especially in livestock prices, for the first effect of the drouth was to add to the slaughter of animals, and the reduction in the supply is only now appearing in the markets.

In addition to the increased receipts from marketings, rental and benefit payments by the A.A.A. during the first six months will exceed those of the first half of last year. Also, this increased income will buy more, in some directions at least, as witness the announcement that the Spring catalogue of one of the two largest mail order houses carries prices 6 per cent below a year ago.

The third reason for anticipating a good Spring business lies in the promised Government expenditures. According to the President's estimate, the Federal deficit for the fiscal year ending June 30 next will be $4,300,000,000, excluding the sinking fund. During the first half of the year the deficit, excluding the sinking fund, amounted to $1,560,000,000. Thus an expenditure of over $2,700,000,000 in excess of receipts is contemplated for the second six months, which is at the rate of $450,000,000 a month. The Treasury has never before in time of peace spent at such a rate except in two months, January and April, 1934, and there is no assurance that it will be able to distribute the sum named within the allotted time. However, enough evidently will be disbursed to support Spring business.

Naturally the foregoing is not the last word on the effects of the Government spending, and the subject is returned to hereafter in this Letter. The paragraph above concerns only the immediate effects on the trade situation.

With these reasons for expecting a satisfactory trade, merchants are hopeful, and wholesale merchandise business during January has been good. The number of buyers in the markets has compared favorably with a year ago, when it was the largest since 1929, and in many lines they appear to be buying more goods. Moreover, the speculative disposition is little in evidence. The wholesale trade represents the judgment of close observers as to the conditions in their own territory, and the state of their own stocks, which all reports agree are lower than a year ago.

Retail sales in New York City during the first half of January were slightly below the 1934 figures, and over the country apparently have shown less of an increase than in December. However, the weather has been unfavorable, January last year was a very good month, and any gain this year is satisfactory. The final figures on Christmas trade were up to expectations. Department store sales for December were 11 per cent over 1934, and up more than seasonally from November; chain stores and mail order houses showed a 14 per cent increase.

The Recovery Movement and the Obstacles

The state of business as described constitutes an encouraging start on the new year. It is the fourth upward swing, counting the brief rise in the late Summer of 1932, since the turn in the world depression about the middle of that year; and hence may be called the fourth great effort of the economic system to extricate itself from the depression, operating through the natural desires and unsatisfied wants of the people and the natural instinct of all business men to do business. The first rise was halted by the Presidential election in the Fall and by the disturbing war debts controversy toward the end of the year, which upset currency relationships and depressed international prices; and all its gains were wiped out by the banking crisis in this country a short time later. The second upswing, in 1933, was pushed to extremes by the accompanying speculation, induced by the inflationary sentiment and by arbitrary cost and price advances; and the setback which followed represented the correction of the speculative excesses, and also the new uncertainties created by arbitrary alterations in economic relationships and by monetary experimentation. The third upward movement, in the Spring of last year, came to grief on the barrier of increased costs and prices and other maladjustments, and on the apprehensions, undeniably widespread, not only as to how the Government policies would affect business, but as to their effect in the end upon the fiscal position of the Government.

Everyone hopes that the present upswing, originating like the others in the everyday wants of the individuals in the economic system, may have a happier end than its predecessors; and everyone must know that the desired end can be achieved if the nature of the obstacles which blocked the previous upswings is understood, and the necessary cooperation is given in clearing them away.

It is regrettable that one effect of the assumption of authority by the Government over economic relationships has been to make many people believe that the Government is primarily responsible for prosperity. Under normal conditions industry, trade and business of all

kinds are carried on by the people without much governmental intervention. The relations involved are those of persons or groups to other persons or groups, and are determined by themselves. The responsibility for adjusting the relations when they become disturbed falls on individuals, who under the pressure of distress have the strongest possible incentive to make the necessary corrections.

The Government is undoubtedly in a position to facilitate the adjustments, and in times of great disorder should properly endeavor to do so. But when the Government assumes the responsibility, and individuals count upon administrative policy to get them out of their troubles, they are not likely to make as effective efforts on their own part to get the system in order. On the contrary, they tend to seek shelter from the necessity for painful readjustments. Those who enjoy or believe they enjoy special advantages, such as arbitrarily fixed money wages or prices, seek the support of the Government in preserving them, and others appeal to the authority of the Government to obtain advantages.

Of course the economic law does not permit any group to enjoy advantages over others for long, but the endeavor to maintain them blocks readjustments, breaks down the exchange of goods, and postpones the recovery. The Government is at a disadvantage in dealing with these problems. Unquestionably its effort is to balance all the factors involved, to establish equitable relations among all groups of the population, and to achieve a sound and lasting equilibrium; but the difficulties have been demonstrated by experience, and in truth the complexities of the situation are almost beyond comprehension. The menace to the recovery is the lack of understanding of the nature of the maladjustments still existing, the want of cooperation in dealing with them, and the mistaken proposals for further changes in economic relationships which would cause new maladjustments.

The Thirty-Hour Week

Within the past month Congress has been asked again to enact into law the 30-hour week for all labor in the manufacturing industries engaged in interstate commerce, with increases in the hourly wage rate to maintain the weekly pay totals. This proposal is out of harmony with the recovery program. Assuming that the standard factory week now averages 40 hours, the 30-hour week would raise wage rates (already at or above the 1929 level) by one-third, and indirect costs by an amount difficult to estimate. The latter would include the higher labor charges added in the prices of materials purchased, and the loss of efficiency which this arbitrary limitation of working hours would undoubtedly cause, at least for some time. The adaptation of work schedules to such a rigid requirement would vary in the different industries, but would be confusing, expensive and time-consuming in all. Also the additional labor hired would naturally be less efficient than the selected workers already employed.

This gives one of the answers to the argument that the proposal would promote recovery. It would involve a simultaneous increase in labor costs and decrease in productive efficiency. It would necessarily cause a rise in prices, and when this rise had gone around the circle the real income of labor, as measured by its purchasing power over the commodities it produces, would be no greater than before. This statement may be disputed on the ground that, since wages are only a part of production costs, the increase would give the workers more purchasing power through the pay envelope than it would take away through the increased price of the product. However, if factory labor made such a gain in purchasing power it would clearly be at the expense of all others called upon to pay the higher prices, and as the others reduced their purchases fewer goods would be made and less employment offered; and indeed this is the most important aspect of the matter.

The manufacturing industries account for only 20 to 25 per cent of the value of the total national output of goods and services, and they find the majority of their customers among the producers of the other 75 or 80 per cent. What would be the reaction of these customers to the increase in the price of manufactured goods? What would be the position of the farmers, which the A.A.A. is trying to raise to a parity with the industries, and of all those dependent upon salaries and fixed incomes? How could they buy as much, and if they could not how could employment be maintained in the manufacturing industries? In short, the last state of labor would almost to a certainty be worse than the first, and general economic conditions would be worse.

Rail Labor Asks Six-Hour Day

Along with the industrial 30-hour week, the Railway Labor Executives Association has declared that it will continue its efforts to have Congress enact the six-hour day and five-day week for railway workers at this session. To be sure, it seems unlikely that the bill will be passed, since the Federal Coordinator of Transportation, Mr. Eastman, has delivered a telling blow against it; but the proposal is disturbing. Mr. Eastman states that the six-hour day, unless it were established at the expense of labor, would add at least $400,000,000 to railroad expenses. The railroads as a whole have been operating for three years at a deficit after paying all charges, and they are

pledged to restore wage rates on April 1, 1935 to the full pre-depression level, which will make them 157 per cent higher than in 1913. The present proposal would increase them at one stroke 33 1/3 per cent above that level.

This proposal is put forward with the claim that it "would extend a ray of hope to approximately 1,000,000 railway employes who comprise one of the largest units of the national army of unemployed". But it may be asked what the hope would be worth if rates were increased to cover the $400,000,000 of cost, as would be necessary? Freight rates, even though unremunerative, are 37 per cent above the pre-war average, and have been reduced only about 8 per cent since 1929, while many of the commodities moving over the roads are still cheaper than in 1913, and on the average are nearly one-quarter lower than in 1929.

This is an instance of a maladjustment in economic relations that is burdening business, diminishing traffic, and blocking recovery. Freight charges enter into all prices, and in many products several times. If the rates should be raised in the effort to obtain another $400,000,000 for labor manifestly there would be further disruption of trade, and further loss of traffic to the roads. How much employment could the railroads continue to give under those conditions? Also, where would the $400,000,000 come from?

Building costs in New York City are estimated by the Dow Service to have advanced under the codes nearly one-third above the low point of the depression and are over 80 per cent higher than before the war, and the effects of these costs in blocking building recovery are demonstrated in the 1934 totals of contract awards, as compiled by the Dodge Corporation for 37 Eastern States. Privately-financed construction again declined, and the total gain was represented by the increase of slightly less than $300,000,000 in public works. The figures, requiring no further discussion, are as follows:

	1934	1933	1932
Publicly-financed	$ 975,384,000	$ 682,698,600	$ 767,667,400
Privately-financed	567,716,500	573,009,800	583,491,300
TOTAL	$1,543,101,300	$1,255,708,400	$1,351,158,700

Plans to Create Purchasing Power

It is recognized that the proposals for wage increases and spreading work are sincerely advocated by many persons not primarily speaking for labor, who believe that the increase in payrolls would represent an increase in purchasing power. This they believe would lead to an increase in consumption, and go around the circle until the depression was overcome. But this conception confuses money with purchasing power, and gives insufficient consideration to the effects of wages on prices, and to the importance of balance among all costs and prices. Purchasing power originates in the production and exchange of goods and services between the various industries and occupations; the goods and services of different kinds pay for each other, and create demands for each other.

There is no source of purchasing power outside of these exchanges. If they are to go on freely, costs and prices must be in equitable relation with other costs and prices, so that the products of each group will exchange equitably. When they do so there is a free flow of purchasing power, and when they do not purchasing power is lacking regardless of the nominal money compensation of each group. Money in the ordinary sense is not a source of purchasing power, but a medium of exchange and a facility of trade; and if money payments made to any group keep the costs of its products out of line, their apparent gain will soon be given up in the loss of sales and employment.

Another fallacy respecting purchasing power is current in many quarters, to wit, that in some way the Government can create and distribute purchasing power, deriving it from somewhere outside of the economic system. This is the basis for another set of proposals for overcoming the depression. It is true of course that the Government can conduct business activity just as a private individual can, and when it finances production purchasing power is distributed as long as the production goes on. But the real question at issue is whether the production will yield a return to pay for itself. If it does not the purchasing power of the body of taxpayers who have to stand the cost will be reduced in a corresponding degree. The seeming gain is deceptive.

The Government is financing its activities by borrowing, and in fact it is borrowing purchasing power. When it borrows capital it borrows purchasing power already stored up as the fruit of past production, and when it borrows credit from the banking system it borrows purchasing power to be created by future production. Borrowings have to be repaid, and everyone is aware that future purchasing power is now being diverted to present use in a degree which will affect the economic situation for many years to come.

The Townsend Plan and the Bonus

The proposals and plans purporting to lead to increases in purchasing power through Government measures are subject to criticism in light of these principles. The Townsend plan to pay a pension of $200 a month to each person over 60 years of age, provided the pensioner did not work at any gainful pursuit and would spend the money within a month, is such a proposal. This measure would require about $24,000,000,000 a year, which it is pro-

posed to raise by a tax on all business transactions. Of course the accumulated taxes, from the first sale of the raw material until the finished article is sold to the consumer, would all fall on the last transaction, which means that the whole amount would fall on that part of the national income spent in trade or the markets. The total national income in 1933, according to the Department of Commerce, was only $46,800,000,000. The Secretary of Labor, Miss Perkins, disposes of the scheme when she points out that it would give 9 per cent of the population more than half the income of the country.

The practical effects of such a plan would be to set going an uncontrollable inflation. The annual tax burden could never be borne except by such an inflationary rise of prices as would raise the national income, in paper money, to fantastic heights. Undoubtedly Germany in the year 1922 could have paid a hundred billion reichsmarks in pensions without turning a hair, but the endeavor of any country to pay it today would duplicate the German calamity.

The proposal to pay the veterans' bonus without waiting for the due date, raising the present value of the certificates by $1,400,000,000, is open to the same criticisms as to principle, but is modest by comparison. It would represent a diversion of future purchasing power to the present, and help trade temporarily, but would be a factor keeping alive the fiscal and monetary uncertainties which are a burden on the recuperative powers of the economic system.

The Present Situation

We are not suggesting that the various proposals we have discussed are all likely to be enacted, but they illustrate fallacious principles which have gained wide acceptance, and which it is fair to say are already embodied too extensively in economic relations, and are responsible for some of the maladjustments existing. They also represent the difficulties with which President Roosevelt has to contend in the effort to reassure public opinion.

The policies of the Administration do not proceed from the belief that Government work can indefinitely maintain the economic system. The President has repeatedly emphasized that the object is to give support only while order is reestablished, and until the system is ready to carry on itself. The gigantic relief bill of $4,880,000,000, to establish work relief for 3,500,000 of the unemployed, is to be interpreted in that light, as a courageous and perhaps daring attempt to start the system going, in the belief that it will get to operating under its own power before the credit of the Government is involved.

Manifestly the prime need of the situation is to get economic relationships in such order that the system will become self-supporting within the indefinite time limit implied. By their very nature the proposals discussed would hamper and disorganize the business organization and prevent it from responding to the President's appeal for cooperation. They would nullify the effects of what has been accomplished in restoring order thus far, and delay the whole program.

Confidence is disturbed by these proposals, as well as by the fiscal and monetary uncertainties, the apprehensions as to labor troubles, and by the difficulty of making goods at a profit at prices which people can pay. The last named problem is the only one which business men can attack as individuals. It is safe to say that they would willingly accept the present wage levels in the manufacturing industries, and rely upon their ability to get costs down in other ways, if they could be relieved of the other uncertainties. However, the others are in the hands of the Government. Governmental decisions are incalculable, since they may not be based upon economic considerations, but it is in them that an answer to the question as to the duration of the present promising trade upswing must be sought.

Money and Banking

The sudden development of doubt as to the outcome of the "gold clause" cases before the Supreme Court caused sharp disturbances in the financial markets during the month. Stock prices reacted abruptly, apparently on the theory that a defeat for the Government would write up the monetary value of the debts of all corporations having outstanding obligations payable in gold, and might even lead to a return of the dollar to the old gold parity, with consequent deflationary effect upon prices. Government bonds containing the gold clause rose to a premium over the non-gold clause bonds. After the first few days much of the excitement quieted down and the markets steadied; nevertheless, holders of gold clause Government bonds continued to show a reluctance to sell, and bonds of this description continued to be quoted, as a general rule, at a fractional premium over non-gold issues.

The most pronounced repercussions of the gold clause cases occurred in the foreign exchange markets, where heavy buying of dollars took place, evidently in anticipation of a rise in the dollar should the Supreme Court decide against the Government. Within a few days sterling dropped from around $4.94 to $4.83½, and French francs from around 6.63½ to 6.44 cents. At the low levels, francs and other gold currencies were well under the gold shipping points, banks and others being reluctant to buy gold abroad in the face of doubt as to whether the Treasury buying price for gold would remain unchanged during the period of

transit. On indications of official intervention in the market, and postponement of the Supreme Court decision to February 4 at the earliest, the demand for foreign currencies revived, resulting in a rebound in sterling to \$4.88½ and in francs to 6.57½. Approximately \$143,000,000 in gold was engaged up to January 25 for shipment to the United States, the latter date marking the day of sailing of the last steamer due to arrive in New York before February 4. Following the 25th, purchases of exchange and of gold fell off, resulting in renewed weakness of rates, and the month closed with all gold currencies below the gold points.

Impracticability of One Form of Managed Currency Demonstrated

The degree of unsettlement caused in the domestic and international markets during the past month by the mere suggestion that the gold value of the dollar might be revised upwards affords an impressive demonstration of the impracticability of at least one particular form of managed currency. This is the plan to control prices by altering the number of grains of gold in the dollar. According to this theory, when prices fall too rapidly (in other words, money appreciates too rapidly in terms of commodities) the decline can be checked by reducing the quantity of gold in the dollar. And conversely, when prices are rising too fast (money depreciating in terms of commodities) the theory is that the movement can be corrected and prices held stable by increasing the quantity of gold in the dollar.

In opposition to these theories, it has been pointed out, among other objections, that a plan of this kind would be defeated by the efforts of speculators and others interested in the foreign exchanges to protect themselves against, or profit by, as the case may be, an expected change in the value of the currency. For example, at the first intimation of an decrease in the value of the dollar there would be a rush to get money out of the country, just as there was early in 1932 and at the time of the bank holiday in 1933. This would cause heavy exports of gold, contraction of credit and forced liquidation—in short, a first class monetary panic. Similarly, at the first hint of any possible increase in the value of the currency the markets would be equally prompt to anticipate such action. Holders of foreign currencies naturally would scramble to buy dollars, and gold would be drained away from foreign countries with a resultant tendency towards credit difficulties abroad. At home, stocks and commodities would be dumped overboard in haste to convert the proceeds into cash or bonds or other assets payable in fixed amounts of money. The demoralization proceeding from such an arbitrary marking up of the value of the currency might be fully as severe as that resulting from arbitrarily marking it down. What business needs is neither a rising nor a falling currency, but stability. Only then can it make plans for the future with confidence.

During the past few days we have had clear proof of the force of the foregoing objections to attempts to regulate prices on a gold basis by changing the gold value of the currency unit. In 1931 and 1932 we had a sample of the havoc that may be wrought by fear of an impending reduction in the gold content of the currency. After the departure of Great Britain from a gold basis doubt as to our ability to maintain the value of the dollar cost us over a billion dollars in gold and a terrific deflation of credit and prices. At the present time we are getting an inkling of the disorder possible were an upward revaluation of the dollar regarded as certain. The mere suggestion of such a move has been enough to throw the markets into a bad state of nerves. While it is quite possible that under present conditions such a revaluation—providing it could be done suddenly and without advance notice—might have consequences less disturbing than is popularly supposed, ordinarily it would be impossible to prevent the markets from having forewarning of an impending change and from attempting to discount it in advance. Such attempts by countless individuals to "beat the gun" in advance of an expected currency revaluation in either direction would surely upset the orderly conduct of business, and could easily provoke serious panic as they have done in the past. It is a mistake to assume that movements of this sort can be controlled as effectively as the advocates of managed currency schemes appear to think.

U. S. Gold Stocks at New Peak

Monetary gold stocks of the United States have continued to increase steadily and on January 23 stood at \$8,308,000,000, a new peak for all time. Since that date additional imports have amounted to \$58,000,000 and approximately \$73,000,000 more is in transit. Altogether over \$380,000,000 of gold has been bought abroad since November 5, when imports were resumed following a lapse of about a month during which gold exports exceeded imports. Including the latest purchases, the net amount of gold imports over exports taken by the United States since the revaluation of the dollar just a year ago has been \$1,315,000,000, which even in terms of old-weight dollars would mark one of the major gold movements of history.

Evidently the United States continues to act as a magnet for gold, despite all that is said as to the necessity of effecting a wider distribution. Various influences have played a part

in directing this flow, including the current speculation on the forthcoming Supreme Court decision, and periodic alarms regarding the political and economic situation in Europe. Fundamentally, however, there can be little question but that the continued attraction of gold to this country is due mainly to the undervaluation of the dollar in terms of foreign currencies, and to a protective tariff policy which bars foreigners from discharging their obligations to us in the normal way—namely, in goods and services.

Bank Reserves at New High

Member bank reserves increased more than $400,000,000 during January, reaching a new high level of $4,501,000,000 on the 23rd. This increase was caused by a combination of factors, including gold imports, the redeposit of $280,000,000 of currency withdrawn from the banks during the holiday season, and Government payments out of balances accumulated in the Treasury and the Federal Reserve Banks. Inasmuch as deposit liabilities failed to increase in the same proportion as did reserves, the volume of excess reserves increased and on the 23rd was close to $2,200,000,000.

Comparing this "excess" with the $4,501,000,000 of actual reserves shown above, it will be seen that the latter are nearly 100 per cent greater than the requirements call for. Or, to put it another way, banks could almost double their present deposit liabilities on the basis of excess reserves alone were it possible for them to find safe use for the huge quantity of lendable funds at their disposal.

Money rates, in consequence of the great surplus of funds, have continued at nominal levels. Open market rates ruled unchanged on the following basis: call money 1 per cent, Stock Exchange time money ¾-1 per cent, prime commercial paper ¾-1 per cent, and bankers acceptances ¼ bid-⅛ asked up to 90-days; weekly offerings of 6-months Treasury bills continued to be discounted at around 0.12 to 0.15 per cent, about the same as in December. The downward readjustment of Federal Reserve rediscount rates continued during the month, the Reserve Banks of Minneapolis, Richmond and Dallas lowering their rates from 3 to 2½ per cent, while the Reserve Banks of Chicago, St. Louis, Philadelphia, and Atlanta reduced their rates from 2½ to 2 per cent. The New York Reserve Bank rate continued unchanged at 1½ per cent, to which it was lowered a year ago.

Further Advance in Bonds

The upward movement of bond prices that has been under way since 1932 continued during January, with prices of numerous issues of high grade municipal and corporation as well as Government bonds establishing new high records. Some irregularity in prices developed around the middle of the month as a result of uncertainty over the outcome of the "gold clause" cases, and many of the lower grade bonds reacted moderately in sympathy with stocks. The market for the best rated corporation issues, however, was practically unaffected and continued very firm, reflecting the huge accumulation of idle bank reserves combined with the diminishing supply of prime bonds available. In the Government group, the gold clause bonds generally sold at a premium over non-gold bonds, but a number from each class reached new high prices.

The following summary of new capital and refunding issues offered in recent years, as compiled by the Commercial and Financial Chronicle, which includes corporate and local governments and stocks as well as bonds, but excludes Federal Government issues, shows that in 1934 there was some revival but that the level is still low as compared with predepression years:

New Security Offerings in the United States
(In Millions of Dollars)

	New Capital Issues			Refunding	Grand
	Corporate	Other	Total	Issues	Total
1919-28*..	$3,512	$1,835	$ 5,347	$1,009	$ 6,356
1929	8,639	1,544	10,183	1,409	11,592
1930	4,944	2,079	7,023	654	7,677
1931	1,763	1,353	3,116	907	4,023
1932	325	867	1,192	538	1,730
1933	161	549	710	344	1,054
1934	178	1,241	1,419	795	2,215

* Ten-year average.

A striking feature of the table is the small amount of new corporate financing last year, which amounted to only $178,000,000 as compared with an average of $3,512,000,000 for the ten-year period 1919-1928. This shows the limited amount of new capital actually going into industry for new plant construction, machinery, etc. Probably the major reason for this low volume is the lack of confidence in future business profits, the same influence that has prevented an expansion of commercial bank credit, but the restrictive effect of the Securities Act of 1933 may have also been a factor. It is interesting to note by contrast that the volume of new capital corporate issues in Great Britain, according to the compilation of the Midland Bank, reached an aggregate of £104,847,000 last year, which was 54 per cent above the total for 1933 and was the largest since 1930, when the total was £121,559,000.

The Budget

The President's budget for the fiscal years 1934-35 and 1935-36, presented to Congress on January 7, proved to be in line with expectations, and therefore created none of the stir which accompanied the forecast of heavy spending a year ago. It has been evident for

some time that the forecast then made of a deficit for 1935 not in excess of $2,000,000,000, exclusive of debt retirement, and of a balanced budget by 1936, would prove too optimistic, and preliminary discussion in Washington had indicated what might be expected. The announcement, therefore, of the actual figures lacked the dramatic qualities of the budget proposals last year.

As the budget message is long and involved, and our space is limited, we shall not attempt any detailed analysis of the figures. The outstanding facts are as follows:

Ordinary expenditures, including interest on the public debt, to be covered by taxation.

A deficit, after emergency expenditures, of $4,300,000,000 for 1934-35, and of $3,900,000,000 for 1935-36, excluding sinking fund.

An increase in the public debt to $34,200,000,000 by June 30, 1936, not including the guaranteed debt which on December 31 stood at $3,200,000,000.

The President does not present a detailed plan for the huge expenditures in contemplation, and doubtless this would be impracticable at this time, but he states the general purpose in explicit language as follows:

I am submitting to the Congress a budget for the fiscal year 1936 which balances except for expenditures to give work to the unemployed. If this budget receives the approval of the Congress, the country will henceforward have the assurance that with the single exception of this item every current expenditure of whatever nature will be fully covered by our estimates of current receipts.

Such deficit as occurs will be due solely to this cause, and it may be expected to decline as rapidly as private industry is able to reemploy those who are without work.

In the regular message, delivered a few days before the budget message, the President had forecast his policy on this subject, saying in part:

The lessons of history, confirmed by the evidence immediately before me, show conclusively that continued dependence upon relief induces a spiritual and moral disintegration fundamentally destructive to the national fibre. To dole out relief in this way is to administer a narcotic, a subtle destroyer of the human spirit. It is inimical to the dictates of sound policy. It is in violation of the traditions of America. Work must be found for able-bodied but destitute workers. The Federal Government must and shall quit this business of relief.

The decision to give work instead of a dole to the unemployed is a bold experiment which has national sympathy. All recognize the demoralizing effects of idlenes, and the improved morale that comes with work. There is agreement that the unemployed and destitute must be cared for in a humane manner, and that this had much better be done by providing work at fair remuneration than by any system of gratuitous public support. The real question is whether so vast an undertaking to provide employment under Government auspices will realize the hopes that inspire it.

The Means of Procedure

The President gives no countenance in either message to radical proposals for changing the industrial order. He recognizes that industry has fallen into confusion, creating an emergency which he assumes will come to an end "when private industry is able to reemploy those who are without work." Furthermore, he gives no sign of approval to plans for raising money by "bootstrap" methods or printing money. His plans apparently accept the sound methods by which Governments have been financed in the past, to-wit, by obtaining money from the producing public through taxation and loans.

This policy is reassuring, for inflation of the currency would raise living costs, multiply labor troubles, unsettle all business relations, and thus increase the confusion, instead of aiding business recovery. It is a fact to be reckoned with, however, that there is a popular agitation for currency inflation and that it is represented on the floors of Congress, for so long as the depression lasts this agitation will be a cause of apprehension.

The Problem of Expenditures for Public Works

The depression increases the burden of government even though expenditures are not increased, for the capacity of the people to bear it is diminished. The expenditure program for unemployment relief is additional to the already augmented burden. We give subsequently a table showing the aggregate of taxes collected over recent years, which shows that the ratio of taxes to the estimated national income was 11.8 per cent in 1929 and 20.0 per cent in 1933. Obviously this increased absorption of income by taxation must seriously affect expenditures for other purposes and also the ability of business to work out of the depression.

The uppermost question now relates to the policies by which the proposed expenditures will be guided. The governing policy of public works and relief expenditures heretofore has been that the Government should set a liberal pattern for private employers. This has been the policy of the P. W. A., the C. W. A., and the C. C. C. The policy of the good employer is seldom challenged in normal times, but under present conditions other considerations are of commanding importance. In the first place, while it may be asumed that the work to be done will have a prospective value, it will be of a class that would not be undertaken now but for the needs of the unemployed.

From the standpoint of the rest of the community it must be regarded as an additional problem and burden at a time when each and every household is beset with new problems and difficulties of its own. Granted that there is a social obligation to care for the helpless, there is a primary obligation for every person

to provide for himself and his family dependents in so far as he can do so, that he and they may not be a burden upon others. It is the individual's own sense of this obligation and of his failure to meet it that causes the humiliation and "moral deterioration" resulting from the continued receipt of public relief. All social obligations are reciprocal; no one owes more to another than the other owes to him, and self respect requires of all of us that we impose no unnecessary burdens on each other.

The "right to work" is real in a proper sense. It is "right" that every one should have an opportunity to work, but as one person's claim on his fellows it is subject to limitations. It cannot be said that he has a "right" to any particular kind of work, or work at any particular rate of pay, or at any particular place, for obviously it might not be possible for every person to be supplied with work on his own terms. The rights of an individual are limited by the equal rights of all other persons, and regard for the general welfare must be the guiding principle.

These considerations require that the policy of aid to the unemployed shall have regard for industrial recovery. First in importance to the common welfare is the maintenance of the economic system in at least its present efficiency, and its restoration to normal capacity as quickly as possible. The monetary system is the very heart of the economic system, and the solvency of the nation is dependent upon both. A breakdown of the monetary system would paralyze industry and plunge the nation into chaos. We have referred to the standing menace of currency agitation and the relation of an unbalanced budget to this peril is the very crux of the problem. Unless favorable results from the policy are evident, the Treasury deficit will naturally become a matter of increasing concern among investors and business men considering long term commitments—the very class of business in which revival is most needed.

The Importance of a Prudent Policy

The public works policy has been inaugurated and will be pursued. We do not dissent from the opinion that productive work rather than mere relief should be provided for the unemployed. Such opposition as has been offered to this policy has been prompted by the high costs of public works, already referred to. This discussion relates to the two schools of opinion, i.e., those who emphasize spending as a means of recovery and those who would conserve the Government's resources and foster the return to self-supporting business.

The President, in his general discussion of the program, laid down a list of conditions which were all commendable, and two are especially notable, because in both he expresses the opinion that the public works should not compete with private enterprise. In one statement he says that the projects should be selected and planned to this purpose. In the other he says that the compensation paid should be "larger than the amount now being received as relief dole, but not so large as to encourage the rejection of opportunities for private employment." Both are consistent with his plan that the emergency employment shall gradually disappear as private industry recovers. Obviously this transfer of employment can only occur upon a basis which will enable private industry to operate continuously and successfully.

In these two statements the President has touched upon the points where the greatest misgivings center. It is difficult to have confidence that any organization political in character will conduct such vast disbursements with an eye to practical economy as known in private affairs. This is not to emphasize the danger of dishonesty but simply the difficulties in ending or restraining such expenditures when once begun. The only practical view is that emergency employment is of a wholly different class from employment upon which profit is made, and that in the interest of the millions of people who are suffering from this depression all governmental finance—national, state and local—should be so conducted as not to obstruct the recovery of private business.

Conditions Requisite to Recovery

The desire of the business community to go ahead with normal activity never is wanting. It is equipped for business and always wanting to do more. Everybody wants to be busy, to produce and sell his products, in order to buy the products of others, and this is the endless round of business. The pace varies from time to time, from causes which affect the offerings in the exchanges, and usually from causes originating outside of the regular circle of trade, such as crop failure, convulsions of nature, war, or new governmental policies. Always a falling off in the volume of business results from changes in the trade relations between the different groups of the system. There is no need to look for the cause elsewhere; always it is there, in unbalanced production, unbalanced prices, governmental obstructions, or something that interferes with normal trade and consumption.

Our readers are familiar with our view that the original cause of this confusion was the War, but whatever the cause it is evident that a serious blockade has existed for now five years. The present administration of national affairs came into the situation about two years ago and has acted energetically to bring the disorder under control. Its management of the banking crisis was very successful. The situation in industry and trade was exceedingly

complicated, the large powers granted by the Congress to the President had to be delegated largely to numerous aids, and they were obliged to be guided very largely by the information and advice received from the various elements in business, hence the responsibility for results has been divided. Of chief importance now are the lessons that may be drawn from the experience.

With a budget deficit in two years aggregating nearly $8,200,000,000, exclusive of sinking fund, the element of *time* is of very great importance in reckoning the consequences of mistaken economic policies, if adopted by the authorities in the regulation of business.

One of the errors about which there can be no reasonable question has been that of assuming that the unemployment since 1929 has resulted from the increased productivity of the industries, instead of from the violent disruption of price- and wage-relations which has hampered the flow of trade. This error was in the assumption that full employment could not be had, which led to the policy of spreading work, reducing hours, raising hourly wages, and discouraging improved equipment, all of which has exerted a repressive influence upon recovery, and if maintained would end industrial and social progress.

Another error was in the theory that the depression had been caused by the excessive profits of industry, which were thought to have left so little purchasing power to consumers that they could not buy the industrial products. We need not repeat here the official figures of industrial profits—both before 1929 and since—which completely disprove this theory. The theory, however, undoubtedly is responsible for the increase of industrial costs and the costs of living which have given a check to recovery in the past year. It is evident that the industries cannot increase employment unless they can sell their products on a basis which will enable them to continue in business.

The point of view of Mr. Walter Lippmann has been of interest to us and we believe will be of interest to our readers. Mr. Lippmann has been a staunch supporter of the President's general policy, and gives strong endorsement to the plan of borrowing for public works, but upon certain important details of industrial policy expresses his opinion as follows:

> Since the balancing of the budget is made dependent upon the revival of business, it becomes the duty of the government to reject policies which obstruct revival and to adopt policies which promote it. This involves a refusal to raise the costs of production before profits are earned, and therefore a refusal to encourage monopolistic prices, monopolistic wages, and the monopolistic restriction of output.
>
> * * * * * * *
>
> The effect of the dole is to freeze wage rates at uneconomic levels. Men stay unemployed because they are not allowed to work except at rates which the community cannot pay. Instead of lowering the hourly cost of labor and going to work, the hourly cost is maintained and men go on the dole. Thus the dole perpetuates itself, as it did in post-war Britain, and tends to stabilize a permanent depression.

Although this comment is directed specifically at the dole, it applies, as does the preceding one, to public works employment if wages are fixed at rates that are out of harmony with the general run of wages and prices, thus preventing the absorption of labor into regular industry. It applies as well to all forms of organized support which increase the inflexibility of the economic system and resist the orderly readjustments which are required to keep the system in balance, and which in the words of Mr. Lippmann tend "to stabilize a permanent depression." He says further:

> If we examine the errors of P. W. A. and C. W. A. it becomes clear, I think, that they arose from a failure to recognize that in a depression men cannot sell their goods or their services at pre-depression prices. If they insist on pre-depression prices for goods, they do not sell them. If they insist on pre-depression wages, they become unemployed. Both P. W. A. and C. W. A. were ruined by the fallacy current in all depressions that a little work or a small volume of sales at a high rate are preferable to much work or a large volume of sales at a lower rate. It is a fallacy not confined to P. W. A. or C. W. A. or the trade unions. It prevailed among most business men when the codes were written.

This comment is confirmatory of a sentence quoted in these columns last month from Bulletin No. 53 of the National Bureau of Economic Research, describing the course of prices from 1929 to 1934, to-wit:

> Declining sales and reduced production were necessary accompaniments of the retarded drop in the prices of manufactured goods.

These quotations describe conditions which tend to prolong the depression and postpone the time when private industry will be able "to reemploy those who are without work."

Experience of Other Countries

The experience of other countries with public works affords a warning against the danger of expenditures which involve continued borrowing. The present government of Great Britain is decisive in its choice that a balanced budget must be obtained above every other consideration. Walter Runciman, member of the cabinet, addressing the World Economic Conference in 1933, said:

> We have in recent years devoted £100,000,000 to schemes of this kind. The result has been on the average that for 1,000,000 in sterling expended we have employed 2,000 men directly and 2,000 indirectly. You will observe this method of dealing with the problem is expensive. In our view it is unduly expensive and an experiment we are not going to repeat.
>
> We terminated our schemes for dealing with the unemployed by capital expenditure on public works and we shall not reopen them no matter whatever is done elsewhere. And if we are asked as a capital market to provide money or raise loans for international public works schemes it is only right that I inform the commission we could not do so. With the experience of the last few years we have come to the

conclusion that whether in our own country or elsewhere schemes of this kind of international public works are the most unremunerative way of dealing with the unemployment problem.

Other Governments have found that an increase of expenditures which unbalanced the budget did not bring compensating gains in the amount of employment. This country's experience in the past year has furnished much evidence to the same effect. The spending agencies have been active practically to their administrative capacity but the showing of increased employment attributable to their activities has not been impressive and the number of persons on the relief rolls has largely increased. The increase of bank loans and investments since June 30, 1933, is more than accounted for by the increased holdings of Government securities.

Total Number of Persons on Relief and Estimated Number of Unemployed in the United States 1933-1934

(000 omitted)

Month	Total Number of Persons on Relief in U. S. (a) As Reported by F.E.R.A. 1933	1934	Total Number of Unemployed in the U. S. As Estimated by the A. F. of L. 1933	1934
Jan.	*	11,105	13,100	11,755
Feb.	*	11,754	13,294	11,443
March	*	13,639	13,689	10,849
April	*	17,004	13,256	10,551
May	*	17,398	12,896	10,248
June	*	17,032	12,204	10,310
July	15,282	17,501	11,793	10,793
Aug.	15,077	18,428	10,960	10,821
Sept.	13,338	18,622	10,108	10,950
Oct.	13,618		10,122	11,039
Nov.	15,080		11,030	11,459
Dec.	11,663	19,500 Est.	10,769	

(a) Includes families and dependents, single persons and transients receiving relief from public funds, but does not include employes of regular and emergency government departments, employes on P.W.A. projects, Civil Conservation Corps, farmers receiving A.A.A. payments, or persons receiving farm, home and other credits.

* Not available.

Gravity of Continuing Budget Deficits

Fallacious arguments are offered to minimize the danger of continuing budget deficits. One of these arguments is that the United States Government debt, even at $34,200,000,000, will still be less than the British debt (about $40,000,000,000) but this overlooks the fact that local governmental indebtedness is not included in these figures. This is much larger in this country than in Great Britain, and when the total of indebtedness is compared the United States will be substantially ahead. Furthermore, the United States is committed to an undertaking of unknown magnitude from which it cannot easily withdraw.

Another argument which does not stand examination is that we borrowed to spend on the War, and this is a War on Depression. This is a plea of moral justification which does not apply to the economic considerations. The correct way of thinking is that the War is responsible for our present plight and that destruction of the monetary system and national credit would make that plight infinitely worse.

The following table compiled by the National Industrial Conference Board shows the changes in the aggregate of national, state and local taxes in this country in the years from 1926 to 1933 and in the ratio of taxes to the total national income in each year:

	Total Taxes Millions	National Income Millions	Taxes to National Income Per Cent
1926	$ 8,605	$ 78,500	11.0
1927	9,059	77,200	11.7
1928	9,342	80,500	11.6
1929	9,759	83,000	11.8
1930	10,266	70,300	14.6
1931	9,300	54,600	17.0
1932	8,147	39,400	20.7
1933*	8,144	40,700	20.0

* Preliminary.

We repeat that these considerations are not offered against the policy of public employment in substitution for the dole, but to emphasize that a prompt return to self-supporting industry is of supreme importance, for obviously Government expenditures and debt-making on the scale now projected cannot go on indefinitely.

Criticism of the Banking System

In the great upheaval caused by the World War, and the resulting unsettlement of economic relations, the banking business has suffered as seriously as any other business, and has suffered from a cross-fire of criticism which on the whole it has not deserved. This is not to say that there was no mismanagement in banking, or that the United States has the best banking system in the world, but simply that the disorders in banking had their origin in extraordinary conditions in the business world, and that the latter had their origin outside of the normal activities of industry and trade. The entire situation was abnormal, and no intelligent discussion of the conditions can be had without an appreciation of the influences set in motion by the war.

The banking system is a vital part of the economic system, and when for any cause the latter is thrown into disorder, the former usually comes in for a major share of the blame. In all countries the banking system is practically a part of the monetary system, although comparatively few persons realize it or understand why it is so. Both are essential parts of the modern, highly organized productive and distributive system. In very early times money was developed as a trade facility, and almost as early banking began to develop economies in the use of money.

Certain crude and mistaken ideas about the privileges and powers of banking are widely circulated and evidently obtain considerable credence. In truth, banking derives no privileges or powers from legislation, for legislation upon banking is regulative and restrictive, rather than a grant of favors. Nothing is done by banking that was not first done by individual traders in the exercise of recognized contractural rights, but on account of the growing importance of the business in community life, laws have been enacted for its orderly regulation, and particularly for the purpose of giving stability to it. There is no objection to the public supervision of banking for this purpose.

A lack of common familiarity with banking seems to account for the critical attitude toward it. There is a natural suspicion of the unknown—of "foreigners" and persons whose sources of income are not of public knowledge; the element of mystery has accounted for beliefs in witchcraft and the existence of "devils." Something of the mystery seems to attach to the banker's undertaking to pay every depositor on demand, although it is obvious that all deposits cannot be paid at the same time. Prejudice is created by representations that bankers control the money supply and manipulate it to serve private interests.

No Mystery or Monopoly in Banking

Banking has no secret or magic or monopoly. The principles are simple. It is one of the oldest businesses in the world, and none is more competitive. There is competition, not only between banks but between banks and other money-lenders, and capital can be shifted into or out of the banking business more readily than from or to almost any other business, for the investment in physical plant is of relatively small importance. If banking were sure of paying better than other lines of business, more capital would flow into it, since bank charters have been as easily obtained by a group of reputable persons as almost any other corporation charters.

As to interest rates, bankers have the potential competition of every person who possesses available capital, bank depositors included, and it is a well known fact that in times of stringency, when interest rates are high, borrowers often resort to depositors and obtain accommodations. It is a matter of record that interest rates are more responsive to the fluctuations of supply and demand than prices and wages generally. The market relation between supply and demand is mainly dependent upon the state of business, i. e., the various conditions which indicate business expansion or contraction. Anyone who employs capital in active business, subject to risks, expects a return in excess of what he could get by lending it at a fixed rate of interest, but on the whole it is doubtful if this expectation is realized. Owners of capital are constantly making conversions between the two modes of employment. The ultimate supply of capital is provided by saving, for if everybody consumed his entire income there would be no growth of capital. The only way to reduce interest rates is by allowing capital to accumulate or increasing its efficiency in use. It cannot be done by printing money.

Creation of Deposits by Loans

Proprietors' capital is a small factor directly in the lending power of banks, for it is scarcely more than enough to provide the ready money required and serve as a guaranty of bank obligations. The principal source of lending power is the deposits, plus the ability of the banks to create deposits by making loans to customers, furthermore making the deposits serve as means of payment through the "clearings", as explained further on. The essence of banking service is in economizing the use of monied capital, facilitating the trade settlements and all cross payments by the system of offsetting claims, or "clearing" as it is called, thus saving not only the risks and costs of transporting money, but the cost of keeping full capital reserves against either currency notes or deposit liabilities. A bank accepts the note of a customer and gives him a deposit credit, which serves him as cash. This bank credit is not, as sometimes said, "created out of nothing," but is based upon customer credit and information as to the ability of customers to meet their obligations. It enters into circulation, is transferred, deposited, and may be transferred repeatedly until retired by being paid off. It is not money or a legal tender, but every person who uses it assumes responsibility for it.

Distribution of Deposit Credit

Competitive conditions are such that the depositors themselves have first claims as borrowers. A regular depositor of good credit standing would have reason for thinking himself ill-treated if he were unable to obtain a loan when he had occasion to want one. Commercial deposits naturally have seasonal fluctuations, varying as to time in different lines. Business houses seldom provide capital of their own for all-the-year needs; they borrow freely for seasonal needs and at other times have surplus deposits. Large companies usually have several bank accounts in order to have a recognized claim to a "credit line" at each one. This priority rule is the chief factor in determining the distribution of credit accommodation, and properly so, for it is the basis of the banking business, affording the chief argument for cooperation in the collection of idle funds into a common reservoir.

It is a mutual arrangement among those who participate, the bank acting virtually as trustee and guarantor. Success in commercial banking depends upon giving satisfaction to depositing patrons in the performance of the various services which they expect of the bank.

Nothing could be more erroneous than the idea that banking dominates all business, for if a desirable patron thinks he does not receive proper consideration he will be met with open arms if he will transfer his account to another bank. Every man who possesses a bank account worth having has abundant opportunities to do this.

It is no longer legal to pay interest on demand accounts, but savings deposits of course draw interest, for no other compensation is given. Such funds are usually invested for longer terms, and to a large extent upon mortgage security, and inasmuch as securities of this kind are on public sale (and might be bought by the depositors themselves) the margin of profit on this class of business obviously cannot be large.

The foregoing affords warrant for saying that there is no way in which the funds entrusted to the banks could be made to serve the "public welfare" more effectively than they are serving it now. If it is proposed to employ them for benevolent purposes, or for either social or economic experiments, the answer is that the bank depositors themselves are the proper ones to make such disposition of them, it being outside the proper scope of banking functions.

The Theory of Monopoly Control

The agitation against banking has been based mainly upon the idea that the banks control the supplies of both money and credit and thus have been able to compel the use of bank credit on a great scale. The theory is that in this manner the public has been unnecessarily loaded with a vast body of indebtedness, representing "fictitious wealth," upon which the banks exact interest charges. What is known as the "Douglas Plan" of substituting "social credit" for all metallic money and bank credit has had some vogue in England, and the literature has been circulated on this side. The Technocrats, during their brief day in print, were bursting with the idea, but the Macmillan publishing house accused them of having stolen it from a book published by that house some years ago, written by Professor Soddy, of Aberdeen University, a man of eminence in his professional field, which is Chemistry. The Soddy book excited no interest among economists, for it contained nothing new that was practical.*

Bank Credit as Means of Payment

In all of the English-speaking countries for many years the chief method of payment has been by the transfer of bank credit, i. e., bank deposits, by private checks. In the United States, formal money issued by the National Government, or by the Federal Reserve banks and National banks under its authority, is still used for payrolls, in retail trade, etc., because it is more convenient for such purposes, but for similar reasons the great body of business clears its transactions by the use of bank checks. It is needless to say that the banks have not forced this change upon the public. The use of checks has been adopted by choice, and there is not the slightest reason to believe that the public ever will go back to the practice of carrying money for making all kinds of payments.

Obviously the term "bank credit" does not necessarily mean borrowed credit. Deposits may be so created, but also are by sales of merchandise. For example, shipments of cotton create credits in the banking centers in favor of our southern states, against which checks are drawn in payment for what those states buy of the outside world; similar credits (deposits) are created by the products of other sections, and the checks given in payment for these various products, when brought together in the clearings, practically offset and cancel each other. Thus in normal times the entire body of what is known as "commercial deposits," as distinguished from deposits which represent "savings," is being constantly turned over, or extinguished and reproduced. The goods and services moving in trade actually pay for each other by the most economical process that can be imagined. The use of legal tender money is reduced to the minimum.

A Refinement of Barter

It is the simplicity of the process which begets the idea that the banks derive great profits from this substitution of book entries or credits for money, and that great gains to the public might be accomplished by having the government perform this service. The

(*) Dr. A. V. Hill, of the Royal Society, England, an organization of Scientists, delivering the Thomas H. Huxley Memorial lecture at Birmingham on November 16, 1933, referred incidentally to what he called the "meddling" of distinguished persons in fields outside those in which they had won distinction, and mentioned Professor Soddy in the following paragraph, which is taken from the February, 1934, number of the Scientific Monthly (U.S.A.):

"Scholars and scientists possess varying degrees of capacity in practical affairs. One disadvantage of prominence in any calling is the fact that the world, at least its newspaper reporters, is apt to believe that the views of the prominent person are of importance in matters altogether unrelated to his special capacity. The views of Bernard Shaw the Jester are quoted on politics or science; Soddy, the Chemist, writes fantastically about economics; famous astronomers get entangled with divinity or metaphysics. No doubt it is to be desired that Shaw would take an interest in science and Soddy in economics; preferably a reasonable and not an emotional interest; my contention simply is that their views need not be taken more seriously than those of more ordinary people."

theory fails to take account of the fact that while this system of settlement achieves a refinement of barter to the last degree, it involves a vast detail of bookkeeping and services, requires large staffs and other expenses, and there is almost no charge for this service, it being given in consideration of the earnings from the deposits. Moreover, an important proportion of the deposit accounts are so active that they do not pay their own costs, although they are a valued convenience to the owners and in the aggregate of much service to the public.

The assumption that modern banking compels borrowing by creating a scarcity of money is the very opposite of the truth. All its facilities and economies have the effect of enabling more business to be done with less moneyed capital, thus cheapening the service of such capital. The gains from specialization in industry, and by the vast increase in productive capacity, have enormously increased the volume of trade, and it is quite inconceivable that this increase could have been handled without the facilities which modern banking has afforded.

Self interest induces bankers to keep their available funds as fully employed as possible, if safe loans are available. The final reserves of credit are in the Reserve banks, and the Reserve authorities have the responsibility of determining when they may be drawn upon. The banking records show that when business is normally active the employment of bank credit is uniformly close to the capacity of the individual banks, which is proof that it is not restricted.

For the most part, borrowing is a voluntary act, in expectation of gain, mainly by consumers in anticipation of income, and business men desiring to do business beyond the limitations of their own capital. Business is not fixed in an unvarying routine, but presents a very active and highly competitive scene. The industries are continually changing, new ones developing, the growing ones wanting more capital to finance their expansion, and the reservoir of liquid capital which banking provides is a highly important factor in all this development.

The Use and Abuse of Credit

There is a legitimate use for credit in giving flexibility to the economic system, enabling a more complete use to be made of the available supply of labor and industrial equipment. On the other hand, when the supply of money and credit already is sufficient to permit the full employment of a country's productive capacity, additional supplies, even in the form of gold, have only the effect of diluting the purchasing power, thus raising prices and stimulating speculation and debt-making. As confidence in rising prices is engendered, ambitious persons develop the policy of borrowing freely, spreading their own capital over as much property as possible, in order to gain the benefit of a further rise, and this goes on until the structure of credit becomes topheavy and comes down with a crash. Economists and students of banking long have pointed out that the only security against these recurring periods of disorder and depression is by restraints upon banking policy which will prevent the inflation of credit and prices, with the accompanying growth of indebtedness. Given the undue use of credit, the speculative rise of prices, the pyramiding of indebtedness, and the outcome inevitably is collapse, deflation and depression. The worse crises, however, have not been chargeable to credit expansion for ordinary business purposes, but to such abnormal influences as war or other developments for which the banking system was not responsible, and which created conditions that were beyond its control.

The Responsibility for Bad Banking

Inasmuch as the banking business in this country has been regulated by law, some share of the responsibility for its conduct must be shared by the law-making and supervisory authorities. If the laws are such as to subject the prudent and careful banker to the competition of rivals whose methods are unsound, high standards of banking practice cannot be maintained. That something has been wrong with the banking system of the United States may be inferred from the fact that although business conditions in Canada have been quite similar to those in the United States, no bank failure has occurred in Canada during the depression. That the Canadian banks have not been able to protect the Canadian people from the effects of a world-wide disorganization of business relations, is true, and it would be unreasonable to say they might have done so. It has meant much for business stability that bank depositors have had unhampered command of their deposits to use as they desired. It has been a demonstration of sound banking. The first obligation of banking is to the depositors, for without them there would be no banking.

In this country, unfortunately, banking legislation became an uppermost subject in politics at a very early day, and from the first the influence of political discussion upon banking legislation was in favor of making credit abundant and cheap, with a corresponding lack of emphasis upon quality. The State bank systems of the first 70 years of the nation's history were largely responsible for this. Their "wild-cat" currencies aggravated the strain of every crisis and the effects of every depression. Under neither State bank nor Na-

tional bank regimes did the banking business have an organization capable of effective control over the aggregate volume of bank credit. The Federal Reserve system probably would have been able to control the private demands for credit, but could not ignore the needs of the United States Government in a great War, and the war-time inflation was responsible for the post-war inflation and all that happened. Neither the economic system, nor banking system, nor any conceivable monetary system can escape the effects of War.

No Question as to Public Authority

There is no question as to the authority of the governments, National and State, over the banking institutions chartered by them. The only question is as to how the authority shall be exercised. It is embodied in part in legislation of direct effect, in part in grants of authority to supervisory officials, and in the case of the National government, to an extensive supervisory organization, the Federal Reserve system. Undoubtedly banking has suffered by the division of authority between the States and Federal Government. It seems altogether desirable that the system shall be unified, and the Federal Reserve plan contains the essentials of what is required. With all of the local communities throughout the country being served by local bankers, naturally of varying degrees of ability, training and experience, the responsibility of supervision calls for an executive organization possessed of a high order of ability, not only in the ordinary meaning of that word, but technically qualified by knowledge of the science and history of banking. The very fact that the functions of banking are so intimately related to all business makes it desirable that the administration shall be as far as possible removed from the political government and the contentions of political parties. If the party in power should be responsible for every fluctuation of prices, the banking administration would be the issue in every election, and nothing could be more disturbing to business. There is no reason for believing that government employes would perform the banking functions more efficiently or economically than they are being performed now.

All Economic Services Involve Costs

Summing up the foregoing, any organized system of handling the vast exchanges of goods and services in modern life will require the employment of both labor and capital, and will inevitably meet with defaults and losses; therefore, there must be charges for the services rendered. We have seen that these services are performed for the most part by the banking system, and it is for these that it receives compensation. To deal concretely with the question of compensation we give below the figures for the aggregate earning assets of all the members of the Federal Reserve system for each year from 1923 to 1932, together with the gross earnings, net profits after operating expenses and losses, net profit per $100 of banks' capital funds and net profit per $100 of earning assets, for each year.

Member Banks of the Reserve System
Ratios of Net Profits to
Earning Assets and Capital Funds
(In Millions of Dollars)

Year	Earning Assets (Loans and Investments)*	Gross Earnings	Net Profits	Net Profit Per $100 of Capital Funds	Net Profit Per $100 of Earning Assets
1923......	26,207	1,719	337	$7.69	$1.29
1924......	27,474	1,786	361	8.04	1.32
1925......	29,674	1,918	419	9.14	1.41
1926......	31,132	2,028	431	8.95	1.39
1927......	32,756	2,120	447	8.66	1.36
1928......	34,722	2,284	504	8.96	1.45
1929......	35,727	2,474	557	8.75	1.56
1930......	35,395	2,229	307	4.56	.87
1931......	33,431	1,912	12	.19	.04
1932......	28.523	1,554	D-255	D-4.50	D- .89

* Figures for earning assets are averages of amounts for call dates during the year. Other figures are for years ended December 31. D-Deficit.

Source: Annual Reports of the Federal Reserve Board.

The years 1923-29 were exceptional years of growing deposits and active demand for credit, therefore favorable to good earnings. The average net profit on the aggregate capital and surplus of the member banks for these years was 8.60 per cent and the average net profit realized on the aggregate earning assets upon which risks were incurred was 1.40 per cent. The two years 1930-31 show smaller profits, and the year 1932 a net deficit, bringing the averages for the ten years down to 6.04 and 0.98 per cent. This is the net compensation not only for loans but for handling the vast system of settlements.

By way of comparison it may be added that the Canadian banking system consists of only ten corporations, but operating about 3,500 branches. According to the findings of a Banking Commission, which reported about one year ago, the average net earnings of these corporations over the preceding ten years had been 6.36 per cent on their capital funds, and average dividends to stockholders 5.93 per cent. The branch banking system undoubtedly lowers both interest rates and capital charges by reducing both operating and capital costs.

Printed in U.S.

n U.S.